

Agenda Item 6B: Conceptual Framework: Elements and Recognition

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IPSASB Meeting

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Objectives of Agenda Item

- (a) To **consider** further the options for dealing with the issue of deferred flows and **provide** directions on key issues identified by staff and the Task Based Group; and
- (b) To **consider** an Issues Paper on the first draft of certain sections of Chapter 5 and **provide** directions on those issues; and
- (c) To **review** a first draft of the final chapter and **provide** directions for further development.

Materials Presented

- Agenda Item 6B.1 Further Issues Paper on Options for Deferred Inflows and Deferred Outflows
- Agenda Item 6B.2 Issues Paper –First Draft of Chapter 5, Elements and Recognition in Financial Statements
- Agenda Item 6B.3 Marked-up Draft of Sections of Chapter 5, *Elements and Recognition in Financial Statements*
- Agenda Item 6B.4 Draft Minutes of September 2013 Meeting

Objective and Nature of Issues Paper at 6B.1 (paras.1-2)

- Identify options for addressing the issue of deferred inflows /outflows
- Obtain directions so that staff and TBG can further develop the final chapter
- Staff Paper with TBG input
- TBG Members will provide comments and identify hybrid compromise Option E (not in Issues Paper)

Background (paras.3-7)

- CF–ED2 issued: November 2013
- Consultation period open until April 30th 2014
 - 40 responses
- SMC 5 (a): Do you agree with decision to define DI & DO?
- SMC 5(b): If in agreement do you agree with
 - i. Restricting definitions to non-exchange transactions
 - ii. Definitions of DI and DO?

Approach in CF–ED2 (paras. 8-10)

- Definitions restricted to:
 - (i) Non-exchange transactions; and
 - (ii) Transactions specifying future reporting period(s)
- Comments that these restrictions not conceptually valid
- Direction at September 2013 Meeting to consider decoupling elements from presentation and develop “in-principle” definitions of DI and DO

The Options in the Issues Paper (paras.11 & 12)

- A. Defining DI and DO in manner that does not predetermine presentation
 - B. Deriving definitions of revenue & expenses from the asset & liability definitions and conveying information on deferred flows through presentation and/or recycling
 - C. Broadening the asset & liability definitions
 - D. Accepting that certain economic phenomena do not meet the definition of an element
- All these approaches have common view that there is value in presenting information on transactions and events that relate to future reporting periods

Option A: Key Features (1) (para.13)

- i. Disengage discussion and decision of elements from presentation in financial statements; and
- ii. Revise definition in principles-based way, so not restricted to non-exchange transactions and specified future reporting periods

Option A: Revised definitions (paras. 16 & 17)

1. Modify definitions in CF-ED2

- A deferred inflow is an inflow of certain resources provided to the entity for use in a future reporting period that increases net assets
- A deferred outflow is an outflow of certain resources provided to another entity or party for use in a future reporting period that decreases net assets

2. Revert to approach in 2010 Consultation Paper

- A deferred inflow: an entity's increase or acquisition of net assets that is applicable to a future reporting period.
- A deferred outflow: entity's consumption or reduction of net assets that is applicable to a future reporting period.

Option A: Advantages identified by supporters (paras. 19 & 20)

- Principled approach that meets objectives and QCs
- Facilitates assessments of operational capacity and cost of services
- Allows ongoing development to better achieve objectives and QCs
- Provides more faithfully representative, relevant, understandable and comparable information on cost of services
- Economic phenomena identified are real (not in paras.)
- Does not involve recycling within one element
- Does not require modifications of asset and liability definitions

Option A: Disadvantages identified by challengers (paras. 21 & 22)

- DI & DO not separate economic phenomena
- Inflows should be recognized as revenue if:
 - Entity controls resource
 - Inflow not an ownership contribution
 - No related obligation
- Outflows should be recognized as expenses if:
 - Entity has no further control of resource
- Decisions on use of elements at standards level with insufficient guidance

Option A: Changes to CF–ED2 required if adopted

1. Remove links from elements to each financial statement
2. Explain that statements for recognition of elements developed at standards level as existing IPSASs being reviewed following issue of Framework
3. Agree definitions of DI and DO and supporting explanation
4. Modify Basis for Conclusions

Option B: Deriving definitions of revenue and expense from asset and liability definitions (paras.23-25)

- Consistent with AV2
- Revenue and expenses in reporting period based on movement in assets and liabilities except ownership contributions and ownership distributions
- Information on resources provided to/by reporting entity for use in future periods through presentation

Option B: Variants (paras. 26-30)

- Variant 1: Revenue and expense to surplus/deficit and presentation of components previously identified as deferred inflow/outflows i.e. Operating Statement
- Variant 2: Revenue and expense to residual amount (net assets) with recycling to surplus/deficit in reporting period of usage
 - Analogy with gains and losses

Approach B: Advantages identified by supporters (paras.23-25 & 27)

- Demonstrates resources for which entity accountable and claims on those resources at reporting date
- Based on transaction-neutral principles
- Allows “pure” definitions of asset, liability, revenue and expense
- Based on principle that “passage of time” not a sound reason for delaying recognition of revenue and expenses
- Variant 1 capable of satisfying information needs through presentation
- Variant 2 achieves same outcome as Approaches A & C without distorting elements.

Option B: Disadvantages identified by challengers (para.26 and 31)

- Variant A (surplus/deficit) may not be representationally faithful of sustainable performance
 - Do not meet objectives of financial reporting and QCs
 - Not mitigated by presentation
- Variant B: (residual amount) may involve recycling within element:
 - Other Comprehensive Income by another name

Option B: Changes to CF–ED2 required if a adopted

1. Delete definition of DI and DO and narrative
2. Modify definitions of revenue and expense and narrative
3. Modify Basis for Conclusions

Option C: Broadening definitions of an asset and a liability (para.32)

- Suggested by small number of respondents to 2010 Consultation Paper
- Illustrative definitions
 - *Assets are economic resources and certain deferred debits that are not resources but are recognized and measured in conformity with GAAP.*
 - *Liabilities are economic obligations and certain deferred credits that are not obligations but are recognized and measured in conformity with GAAP.*

Option C: Advantages identified by supporters (para.33)

- Does not require development of separate elements
- Revenue & expenses based on movements in assets and liabilities apart from OC & OD
- Allows standard setter to respond to circumstances

Option C: Disadvantages identified by challengers (para.34)

- Distorts essence of asset and liability elements (BC41 of CF)
 - Asset definition includes resources that entity does not control
 - Liability definition includes obligations that are not present obligations
- Allows standard setter to determine what is a deferred credit or deferred debit on ad hoc basis
 - Does not define anything (Storeys)

Option C: Changes to CF–ED2 required if a adopted

1. Modify definitions of an asset and a liability
2. Eliminate DI & DO definitions and section
3. Add supporting narrative to explain that definition includes deferred credits (inflows) and deferred debits (outflows)
4. Modify and simplify definitions of revenue and expenses so based on movements in assets and liabilities
5. Modify Basis for Conclusions

Option D: Accepting that certain economic phenomena do not meet definition of any element (para.36)

- Identify and define 6 elements-asset, liability, revenue, expenses, ownership contributions & ownership distributions
- No defined elements for deferred inflows and deferred outflows
- Acknowledges economic phenomena that do not meet definition of elements
 - I. Recognize in financial statements
 - II. Recognize in GPFRs outside the financial statements
 - III. Outside scope of GPFRs

Option D: Advantages identified by supporters (paras.37-40)

- Transparent
 - Acknowledges current reality and current position reached by conceptual thinking
- Avoids “shoehorning” (forcing) transactions/events into existing elements
 - Provision of right to operator of service concession arrangement
- Avoids defining additional elements at this time
- Does not modify asset and liability definitions (unlike Option C)

Option D: Disadvantages identified by challengers (para.41)

- Not transparent
 - Can lead to transactions/events being classified as assets and liabilities when they do not meet the definitions
- Inappropriate to define elements but not all encompassing
 - Diminishes accountability & allows avoidance of use of defined elements on ad hoc basis
- Impact on revenue & expense definition unclear
 - Based on movements in A & L or not?
- Inadequate guidance for standard setter

Changes to CF–ED2 required if a adopted

1. Delete definitions of DI & DO and section
2. Modify Section 1
 - Explain nature of these other economic phenomena
3. Modify definitions of revenue and expenses, net assets and explanation of recognition?
4. Modify Basis for Conclusions

Option E: A Further Hybrid Approach

- Draws on discussion of resources and obligations
 - Resource is an item with ability to provide service potential or economic benefits
 - Obligation is an act or course of action to which an entity is morally or legally bound.
- Asset and liabilities sub-sets of broader resources and obligations
- Responds to consultation comments on need to expand notion of assets and liabilities

Option E: Implications for Way Forward (1)

- More open approach to elements
- Allows reporting of inflows and outflows that do not affect assets and liabilities as defined e.g., securitization
- Allows possibility of reporting of inflows and outflows that do not affect revenue and expenses
 - Definition of revenue and expenses could be independent of movements in assets and liabilities other than ownership contributions/distributions
- Key Question: Whether to define these other economic phenomena in Conceptual Framework

Option E: Implications for Way Forward (2)

- If defined: modified CF-ED2 DO & DI, A, C or B (Recycle if meets objective of surplus/deficit reporting)
 - Formulating definitions problematic!
- If not defined D or A (implicit) or B (implicit)
 - Section 1 of Chapter 5 acknowledges other possible elements and explanation of view in Basis for Conclusions
 - Addressed at standards level esp. IPSAS 1 and IPSAS 23 revisions



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